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AUDITOR-CONTROLLER

**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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August 1, 2003

TO: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley 
Auditor-Controller

SUBJECT: **WORK ORDER NO. 6-38 – 2002-03 DEPARTMENT OF PUBLIC
WORKS' LAC+USC MEDICAL CENTER REPLACEMENT PROJECT
ADMINISTRATION SPECIAL STUDY**

The Department of Public Works (Public Works) and the consulting firm of JFI are responsible for overseeing the construction of the Los Angeles County + University of Southern California (LAC+USC) Medical Center Replacement Project (Project). The Project will replace four existing hospital facilities on site to provide a new medical center totaling approximately 1,500,000 square feet. The Project is composed of four distinct building components including a 600-bed Inpatient Tower, a Diagnostic and Treatment Facility, an Outpatient Clinic Building, and a Central Plant.

At Public Works' request, we contracted under our Master Agreement with Thompson, Cobb, Bazilio & Associates (TCB&A or auditor) to perform an assessment of the adequacy of internal controls over the fiscal administration of the Project. As part of its assessment, TCB&A also reviewed controls over contract changes and change orders.

Summary of Findings

TCB&A's assessment determined that the Project's internal control environment is adequate. Below is a summary of the key areas reviewed.

Fiscal Compliance Measures

The auditor determined that the Project is in compliance with Public Works' Project Management Division Procedures Manual, the County's Capital Project Development Document, and Title 44 of the Code of Federal Regulations. However, the auditor

recommended that Project staff consider developing desk instructions to further augment the Project Management Division Procedures Manual for certain processes.

Procurement, Use and Safeguarding of Assets

The auditor determined that controls over the procurement, use and safeguarding of assets were adequate. For example, the auditor determined that all reimbursable expenditures are recorded and classified into reimbursable expense categories. Purchases of assets greater than \$1,000 through fiscal year 2002 were made in compliance with section PMD-2 of the Project Management Division Procedures Manual, and proper authorization and approvals were obtained in advance of the purchases. Also, all assets were properly tagged and periodic inventories were conducted.

Contract Change Controls

The auditor determined that Public Works has established procedures to ensure that prices for contract changes are fair and reasonable. Public Works' approval levels were consistent with State law and County ordinances except for changes to contracts with values between \$250,000 and \$1,250,000. This was corrected on December 3, 2002. The auditor recommended that Project Management Division I ensure Public Works' Project staff compares certified payrolls of prime and major subcontractors with rates used for negotiating changes on at least an annual basis. Additionally, the auditor recommended that Project staff establish a procedure requiring that change order approvals include a checklist evidencing that procedures for establishing reasonable prices have been followed.

Contractor Payments

The auditor's detailed testing of invoices determined that contractor and consultant billings and payments were accurate, properly authorized/approved, supported by adequate back-up documentation, and were being billed in accordance with contract provisions and applicable Public Works procedures.

Use of Optional and Reimbursable Service Components in Consultant Service Contracts

The auditor determined that there appears to be no discernable risk in the use of contract options to the County at this time, since the use of contract options was found to be minimal. Reimbursable service components were found to exist in two of the 13 consultant service contracts. Initiation and use of the reimbursable provisions under these two contracts was found to be in compliance with the Project Management Division Procedures Manual.

Review of Report

Public Works' response, which is attached, indicates agreement with the auditor's findings and that the Department has begun to take action to implement the report's recommendations.

Please call me if you have any questions, or your staff may call DeWitt Roberts at (626) 293-1101.

JTM:DR:KVO

c: David E. Janssen, Chief Administrative Officer
James A. Noyes, Director, Department of Public Works
Violet Varona-Lukens, Executive Officer
Public Information Office
Audit Committee



JAMES A. NOYES, Director

COUNTY OF LOS ANGELES

DEPARTMENT OF PUBLIC WORKS

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IN REPLY PLEASE

REFER TO FILE: FI-2

July 24, 2003

TO: J. Tyler McCauley
Auditor-Controller

FROM: James A. Noyes *JAN*
Director of Public Works

RESPONSE TO THE LAC+USC MEDICAL CENTER REPLACEMENT PROJECT – PROJECT ADMINISTRATION SPECIAL STUDY

Attached is Public Works' response to the recommendations contained in the final report prepared by Thompson, Cobb, Bazilio, and Associates, PC. As noted in the response, we agree with the recommendations and have begun efforts with Project Management Division I to meet the recommendations cited in the report.

We would like to thank the Auditor-Controller for allowing Public Works to use their Master Agreement list and for coordinating the efforts. If you have any questions, your staff may contact Raymond Low, Head of Internal Audit, at (626) 458-6950.

RL
RL:cb

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Attach.

PUBLIC WORKS' RESPONSE TO THE LAC+USC MEDICAL CENTER REPLACEMENT PROJECT - PROJECT ADMINISTRATION SPECIAL STUDY

RECOMMENDATION #1

The DPW Project staff should consider developing desk instructions to further augment the DPW Project Management Division Procedures Manual for certain processes. Specifically, instructions and a template should be developed for compiling and updating the monthly Project report since the content of the monthly report differs from the requirements as detailed in PMD-11. Since most of the information required by PMD-11 appears to be included in the Project's monthly report in a slightly modified form, desk instructions should provide the detail of tasks required for report compilation. Similarly, desk instructions should clarify which procedure should be used for contractor pay request processing, i.e., PMD-12A for single funding source or PMD-12C for multiple funding sources. The desk instructions should also include the levels of signature authority, a flowchart outlining sequence of events, define internal controls and responsibilities, and provide timelines.

RESPONSE

Public Works agrees with the recommendation. Our Project staff will develop desk instructions to ensure that the monthly report agrees with the requirements in PMD-11. Furthermore, desk instructions will be developed to clarify procedures used for contractor pay request processing.

STATUS

Target for implementation – August 1, 2003

RECOMMENDATION #2

Project Management Division I should ensure our Project staff compares certified payrolls of prime and major subcontractors with rates used for negotiating changes on at least an annual basis to ensure that rates negotiated for changes are consistent with actual rates experienced by those contractors. Whenever differences are noted, any preestablished negotiated rate should be revised accordingly.

RESPONSE

Public Works agrees with the recommendation. Project Management Division I will ensure our Project staff compares certified payrolls on an annual basis.

STATUS

Target for implementation – August 1, 2003

**PUBLIC WORKS' RESPONSE TO THE LAC+USC MEDICAL CENTER
REPLACEMENT PROJECT - PROJECT ADMINISTRATION SPECIAL STUDY**

RECOMMENDATION #3

DPW Project staff should also establish a procedure requiring that change order approvals include a checklist evidencing that procedures for establishing reasonable prices have been followed. This checklist should include, at a minimum, statements that equipment and labor rates proposed for a change order have been compared with advanced agreement rates, and that new advanced agreement rates have been established after assessment of proposed rates for those cases where no advanced agreement rate exist. This checklist should also include a statement that the proposal has been reviewed to ensure that mark-up on labor, material, and equipment has appropriately been included on the deleted work.

RESPONSE

Public Works agrees with the recommendation. Our Project staff will establish a procedure requiring that change order approvals include a checklist evidencing that procedures for establishing reasonable prices have been followed.

STATUS

Target for implementation – August 1, 2003

**COUNTY OF LOS ANGELES
AUDITOR-CONTROLLER**

**LAC+USC
Medical Center Replacement Project
Project Administration Special Study**

May 30, 2003

Submitted by

TCBA

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May 30, 2003

Mr. J. Tyler McCauley, Auditor-Controller
County of Los Angeles/Department of Auditor-Controller
320 West Temple Street, Room 380
Los Angeles, CA 90012-3208

Dear Mr. McCauley:

Thompson, Cobb, Bazilio & Associates, PC is pleased to present the attached project administration special study report of the Department of Public Works LAC+USC Medical Center Replacement Project (the "Project"). The primary purpose of this study was to assess the adequacy of internal controls over fiscal administration of the Project and to ensure contract changes and change orders are adequately controlled.

We would like to thank DPW and Project staff for their cooperation provided to us throughout this study. If you should have any questions, please feel free to call me anytime at 310 792-7001.

Respectfully,



Michael J. deCastro
Principal

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EXECUTIVE SUMMARY

At the request of the Department of Public Works, the County of Los Angeles Auditor-Controller engaged Thompson, Cobb, Bazilio & Associates, PC to perform a voluntary internal control assessment of the Los Angeles County+University of Southern California Medical Center Replacement Project (the "Project"), as a proactive measure, and prior to major construction activity, to ensure that the Project has adequate internal controls in place over the following five key areas:

- ✓ Fiscal Compliance Measures
- ✓ Procurement, Use and Safeguarding of Assets
- ✓ Contract Change Controls
- ✓ Contractor Payments
- ✓ Use of Optional and Reimbursable Service Components in Consultant Service Contracts

The internal control environment of an organization is established by top management and includes factors such as management's commitment to structure, accountability, ethical values, and well-documented policies and procedures. An adequate system of internal controls is key to ensuring fiscal accountability since internal controls are defined as the ability of an entity to monitor and control its operations.

Our internal control assessment of the Project found that the internal control environment is adequate. We found the Project staff is committed to structure, accountability, and ethical values. Management and staff appear knowledgeable and cognizant of the County's Department of Public Work's (DPW) Project Management Division Procedures Manual (manual). We observed an efficient and cohesive project management team comprised of DPW Project Management Division I employees and project consultants.

Compliance With the DPW Project Management Division Procedures Manual

The Project utilizes and relies on guidance from the DPW Project Management Division Procedures Manual for effective project management. This manual contains, among other things, procedures pertaining to fiscal matters, which include cost data capture control, fiscal reporting, and documentation. Based on our interviews with management and staff of the Project, and review of pertinent documents and reports from the Project's files, we found the Project to be in compliance with the manual.

While noting compliance with the manual, the DPW Project staff should consider developing more detailed project specific desk instructions for selected areas

(i.e., monthly project reporting, contractor pay request process) to augment the DPW Project Management Division Procedures Manual. Desk instructions would be beneficial in defining project specific roles, responsibilities, and levels of authority. It would also assist in assuring project continuity, implementation of internal controls, and institutional knowledge. (See pages 8-9)

Compliance With the County's Capital Project Development Document

The Department of Public Works and the County's Chief Administrative Office (CAO) were found to be in compliance with the requirements of the County's Capital Project Development Document. This document defines the roles and responsibilities of the DPW and CAO in implementing the County's Capital Project Development program and addresses key areas such as budget control, status reporting, document control, and cost control.

The Federal Emergency Management Agency (FEMA), as well as local matching funds in the form of short and medium term financing fund the Project. Title 44 of the Code of Federal Regulations, Emergency Management and Assistance, Chapter 1 of FEMA provides the administrative requirements for tracking and reporting the use of FEMA funds. The use of FEMA funds for the Project is limited to eligible expenses for general acute care hospital or acute care psychiatric hospital buildings.

A method has been developed to prorate total costs for the Project based on the cost of FEMA eligible facilities to determine FEMA eligible expenses. The responsibility for tracking and reporting the use of FEMA funds has been assigned to the CAO's office. The Project's CAO liaison has identified FEMA eligible costs that exceed the total amount of FEMA funds the County will receive by approximately \$150 million. (See pages 9-10)

Compliance With Project Documentation and Record Retention Requirements

The Code of Federal Regulations (CFR) requires that Project records must be maintained for a period of three years and further establishes the starting point for the beginning of record retention. The DPW Project Management Division Procedures Manual also establishes the requirements for filing incoming correspondence at the Project site level. The Project's procedures include document imaging, quality control measure for document indexing, retention of physical files on-site for two years, and off-site archiving of older documents with no provision for document destruction.

The Project staff has implemented a project documentation system that meets or exceeds the requirements of the Capital Project Development Document and CFR. In addition, an upgrade of the existing document control software and

system was completed in February 2003, which should further enhance the Project documentation requirements. (See page 10)

Controls Over the Procurement, Use and Safeguarding of Assets

All portable and fixed assets have been purchased through the reimbursable portion of the Construction Management Contract with Jacobs Facilities Incorporated (JFI). These purchases, consisting primarily of furniture and fixtures, computer hardware/software, and equipment, are governed by the requirements contained in PMD-2 of the Project Management Division Procedures Manual.

Asset purchases were acquired in compliance with PMD-2. Proper DPW authorizations and approvals were obtained in advance of these purchases. Assets are properly tagged, furniture and equipment is assigned to individuals and location, periodic inventories are conducted, and the office security system is operating effectively. Adequate procedures were found to be in place to ensure that the custody of assets is properly accounted for when employees transfer in or out of the Project. (See pages 11-12)

Review of Contract Change Order Procedures

Adequate contract change order procedures are in place to ensure that price changes are fair and reasonable. Contractors are required to provide itemized breakdowns with change order proposals that provide all added and deleted labor, material, and construction equipment. Contract change order procedures also require pre-negotiated labor and equipment rates for prime contractors and major subcontractors. Proposed rates are verified to union agreements, prevailing wages and/or certified payrolls. A reasonableness assessment of equipment use rates is also made to industry standards. Negotiation of "advanced agreement" labor and equipment rates is also done for future change order negotiations.

Requiring that change order approvals include some form of documentation (i.e., a checklist) verifying that change order pricing reviews have been performed could enhance contract change order controls. Periodic review of advanced agreement labor rates with actual labor rates paid as shown in contractor certified payrolls could also enhance controls over the change control process. (See pages 13-14)

Contract Change Order Approval Levels

Written procedures governing contract change control approval levels are contained in PMD-10. Approval levels identified in PMD-10 were consistent with State law and County ordinances, except for changes to contracts with values between \$250,000 and \$1,250,000. PMD-10 states that DPW could authorize

changes for contracts with original values between \$250,000 and \$1,250,000 equal to 10% of the contract's value up to \$75,000. However, State law would allow DPW to authorize changes with values equal to 10% of the first \$250,000 in original contract value and 5% of the amount over \$250,000 up to a change order value of \$75,000. This inconsistency was discussed with DPW management on November 18, 2002, and a revision to PMD-10 was made on December 3, 2002, consistent with State Public Contract Code Section 20145. (See page 14)

Controls Over Payments to Contractors and Consultants

The processing of contractor pay requests and consultant invoices is governed by the requirements contained in PMD-12A and PMD-12B. Our testing found the Project's contractor and consultant payment process is in compliance with PMD-12A and PMD-12B.

We performed detailed testing of 49 invoices applicable to nine contractors/consultants totaling \$15,750,000 of expenditures during fiscal years 2001 and 2002, which represented 47.5% of the total dollars of contract expenditures during this time period. Consultant/contractor billings tested were accurate, properly authorized/approved, and properly supported. (See pages 15-16)

Use of Optional & Reimbursable Service Components in Consultant Service Contracts

Contract options are defined as unfunded itemized requirements that may be initiated at the direction of the County. Contract options are not included in the consultant's not-to-exceed fee and require a supplemental agreement to initiate. We found that a contract options clause exists only in the Construction Management Contract with JFI and is limited to post occupancy planning and an owner-controlled insurance program. JFI's contract options clause has not been initiated to date.

Reimbursable service components were found to exist in two of the thirteen consultant service contracts. Funds totaling \$3.6 million were budgeted for reimbursable expenses in the Construction Management Contract, amounting to only 7.5% of the total construction management budget. Funds totaling \$451,000 was budgeted for reimbursable expenses in the Architectural and Engineering (A/E) Design Contract, amounting to only 1.0% of the total A/E Design Contract budget. Initiation and use of the reimbursable provisions under these two contracts was found to be in compliance with the contract provisions. (See pages 17-18)

BACKGROUND

The Los Angeles County+University of Southern California Medical Center Replacement Project (the "Project") will be the largest safety net health facility provider for the uninsured, particularly for high acuity specialty services not sufficiently available in the community. The Project will serve as the County's principal point of contact for the County's health care delivery system, providing a wide range of inpatient, outpatient, trauma and emergency services to a County population of more than nine million residents.

On December 3, 2002, the Board of Supervisors awarded a construction contract to McCarthy, Clark and Hunt. The estimated project completion date is January 21, 2007.

Prior to the 1994 Northridge Earthquake, the former LAC+USC Medical Center campus comprised over 128 buildings on a 80-acre site with a core of four hospitals: General, Women's and Children's, Psychiatric & Pediatric. As a result of this major earthquake, these four facilities sustained varying degrees of structural damage. For example, the Psychiatric and Pediatric hospitals were "red-tagged" and closed, as they were considered unsafe for occupancy and were subsequently demolished.

The Department of Public Works Project Management Division I, along with the consulting firm of JFI is responsible for overseeing the construction of the Project. The Project will replace four existing hospital facilities on site to provide a new medical center totaling approximately 1,500,000 square feet. The Project is composed of four distinct building components as follows:

- ✓ Inpatient Tower
- ✓ Diagnostic and Treatment Facility
- ✓ Outpatient Clinic Building
- ✓ Central Plant

A brief description each specific project component follows:

Inpatient Tower

The Inpatient Tower will be an eight-story structure comprising approximately 681,000 square-feet. It will provide 600 patient beds consisting of:

- ✓ 130 Adult Medical/Surgical Intensive Care Units
- ✓ 295 Medical/Surgical Acute Care Units
- ✓ 10 Burn Acute Care Units
- ✓ 10 Burn Intensive Care Units
- ✓ 24 Bed Jail Unit

- ✓ 10 Pediatric Intensive Care Units
- ✓ 25 Pediatrics Acute Care Units
- ✓ 40 Neonatal Intensive Care Units
- ✓ 32 Obstetric Care Units
- ✓ 24 Psychiatric Acute Care Units

The services that will be provided in the new facility include food and central services, psychiatrics, general administration, pediatrics, neonatal, and women's services, burn unit, jail ward and pharmacy. All aspects of construction will be included in this scope including structural, architectural, mechanical, electrical plumbing and equipment supply. The exterior will consist of pre-cast concrete panels, metal panels, glazed curtain wall and built-up roofing.

Diagnostic and Treatment Facility

This building will be a five-story, 430,000 square-foot isolated structure. It will house some of the most medically sophisticated services found in the Project including diagnostic imaging, radiology, surgery, emergency services, core lab, inpatient pharmacy, the diagnostic center, central sterile supply, radio-pharmacy and the trauma helipad. The Diagnostic and Treatment (D&T) facility is designed with a seismic base-isolation system beneath its entire 76,650 square-foot base. This structure is located between the Outpatient Department (OPD) the Inpatient Building and, as a result of the base-isolation system; the D&T will be the "life boat" component of the Project in the event of a major earthquake.

Outpatient Department Building

The OPD will be a seven-story structure comprising approximately 334,000 square-feet. It will contain the specialty-type clinics such as radiation oncology, outpatient pharmacy, psychiatric, pediatrics, ENT/Audio/Speech, women's services, dental, orthopedics, medical/surgical, neuro-diagnostic, and ophthalmology. It will also include clinic registration, billing, employee health, childcare, quality assurance, education, and information system. The primary exterior building enclosure consists of pre-cast concrete panels, glazed curtain wall system with metal panels and built-up roofing.

Central Plant

The Central Plant work will consist of excavation, shoring, grading, and construction of a 60,000 square foot single story, below grade, reinforced concrete building and utility tunnel to the Diagnostic and Treatment Building. The work also includes installation of HVAC equipment, fire/life-safety systems, cooling towers, emergency generator, mechanical/electrical/plumbing systems and communication systems.

There are also three auxiliary component efforts of the Project as follows:

Site Preparation

The Site Preparation work included demolition of the existing Pediatric and Psychiatric Hospitals, Grad Hall, Muir Hall, Parking Structures No. 6 and 11, and other miscellaneous structures as well as removal of abandoned underground structures, capping/sealing utilities and tunnels to those structures. Utilities were relocated to serve existing buildings that will remain. The work also included mass excavation with temporary and permanent shoring for new hospital facilities, as well as rough grading for future building improvements. Finally, the work included construction of a new Metropolitan Transit Authority (MTA) route for the existing OPD and widening and re-alignment of the Cummings, Charlotte and Chicago Streets.

Move Transition

Move Transition activities were accomplished by Job Order Contracts. The activities included relocation of the College of Nursing and Allied Health, Outpatient Psychiatric Services and other miscellaneous hospital operations from Graduate Hall and Muir Hall in preparation for demolition of these buildings. Relocation of these operations required tenant improvement work in various locations around the hospital campus including General Hospital, Interns, & Residents Dormitory, and four buildings at the North Campus. This phase also included hazardous material abatement activities in all buildings that are scheduled for demolition.

Final Site Preparation

The Final Site Preparation includes landscape and hardscape for the Project. The scope of this site work includes planting trees, shrubs and vines around the new buildings, construction of a courtyard to provide seating, resting, outdoor eating areas, stairs, a bus stop seating area, and site directional signage. Screen walls and stairs will be formed into different shapes to create a unique and restful courtyard setting. Construction of surface parking will occur.

RESULTS

I. Fiscal Compliance Measures

Objectives

Our primary audit objective was to determine whether the Department of Public Works (DPW) Project staff has established proper fiscal policies, procedures and internal controls over the Project and is in compliance with these guidelines. In particular, our objective was to provide assurance that:

- 1) The cost data capture and reporting activities are in compliance with the Federal Emergency Management Agency (FEMA) regulations (e.g., Applications Handbook, Code of Federal Regulations Chapter 44) and requirements; and
- 2) The Project is in compliance with the DPW Project Management Division Procedures Manual.

Scope

To accomplish our objective in this area, we obtained and reviewed the following pertinent documents:

- 1) FEMA administrative requirement established in Title 44 Code of Federal Regulations, Emergency Management and Assistance, Chapter 1, Federal Emergency Management Agency
- 2) FEMA Office of inspector General, Consolidated Audit Guide, March 2001
- 3) FEMA Seismic Hazard Mitigation Program for Hospitals, revised November 15, 1996 and April 15, 1998.
- 4) The DPW Project Management Division Procedures Manual
- 5) The County of Los Angeles Capital Project Development Document, revised September 1997.

In addition, we also conducted interviews with various personnel from the County, Project Management Division I, and JFI.

Results

Compliance With the DPW Project Management Division Procedures Manual

In the absence of specific policies and procedures, the Project adheres to the DPW Project Management Division Procedures Manual and supplements those basic procedures with staff training from supervisors for specific case-by-case procedures deemed too detailed for inclusion in the manual. This manual contains several procedures pertaining to fiscal matters which include cost data capture control, reporting

and documentation. Based on our review of these procedures and interviews with the various responsible staff members, we found the Project to be in compliance with the manual. Areas where current Project practices differ from the manual include organization and content of the monthly Project report and timeframes for reviewing and paying contractor pay requests. Also, since the CAO has assumed responsibility for FEMA reporting, the need to track different funding sources separately as stipulated in the manual is currently not relevant.

While noting compliance with the manual, the Project could benefit from developing desk instructions in certain critical areas to augment the manual. Desk instructions would be beneficial in defining roles, responsibilities, and levels of authority, and would help assure Project continuity, implementation of internal controls, and institutional knowledge, all of which are important given the high visibility of the Project

An initiative was started by the DPW Project staff to develop an 11-volume Project specific procedures manual. The effort to develop this Project specific manual was subsequently discontinued before completion for several reasons including cost, shifting priorities, and the comfort level of the staff's familiarity with the Project's requirements. Volumes of this manual that we reviewed included: Administrative Procedures (Volume II), Agency Review/Interface/Permits (Volume V), and Contract Document Control/Plan Room (Volume VII).

Recommendation

The DPW Project staff should consider developing desk instructions to further augment the DPW Project Management Division Procedures Manual for certain processes. Specifically, instructions and a template should be developed for compiling and updating the monthly Project report since the content of the monthly report differs from the requirements as detailed in PMD-11. Since most of the information required by PMD-11 appears to be included in the Project's monthly report in a slightly modified form, desk instructions should provide the detail of tasks required for report compilation. Similarly, desk instructions should clarify which procedure should be used for contractor pay request processing, i.e., PMD-12A for single funding source or PMD-12C for multiple funding sources. The desk instructions should also include the levels of signature authority, a flowchart outlining sequence of events, define internal controls and responsibilities, and provide timelines.

Compliance With the County of Los Angeles Capital Project Development Document

The County of Los Angeles Capital Project Development Document defines the roles and responsibilities of DPW, the CAO, and the Department of Health Services in implementing the County's Capital Project Development program. DPW has overall responsibility to provide project management services, direct all technical aspects of the process and manage the consultants involved in Project design, construction and delivery. Similarly, the CAO has responsibility for the overall management of the

development of capital projects, budgetary oversight, scope control, and reporting to the Board.

The Project was found to be in compliance with the requirements of the County of Los Angeles Capital Project Development Document.

Compliance With Title 44 of the Code of Federal Regulations

FEMA, as well as local matching funds in the form of short and medium term financing fund the Project. Title 44 of the Code of Federal Regulations, Emergency Management and Assistance, Chapter 1 of FEMA provides the administrative requirements for tracking and reporting the use of FEMA funds. The use of FEMA funds is limited to eligible expenses for general acute care hospital or acute care psychiatric hospital buildings. For this Project, the eligible buildings are the Inpatient Tower and the Diagnostic and Treatment Building. FEMA funds can also be applied to portions of the Central Plant, Site Preparation and Final Site Work that benefit the eligible buildings on a prorated basis only.

The responsibility for tracking and reporting the use of FEMA funds has been assigned to the CAO's office. We found the CAO's office to be in compliance with Title 44 of the CFR. A method has been developed to prorate total costs for the Project based on the cost of FEMA eligible facilities to determine FEMA eligible expenses. The Project's CAO liaison has identified FEMA eligible costs that exceed the total amount of FEMA funds the County will receive by approximately \$150 million. Despite the CAO having submitted the underlying assumptions and method utilized for determining the reimbursable amounts to FEMA in January 2001, confirmation has not been received from FEMA as to its acceptability in tracking eligible costs. We were informed that previous attempts to obtain written confirmation from FEMA in this regard proved to be unsuccessful.

Project Documentation and Records Retention

The Code of Federal Regulations, as per Title 44, Section 13.42 (b) requires that records must be maintained for a period of three years and further establishes the starting point for the beginning of record retention. As well, PMD-6.1 establishes the requirements for filing incoming correspondence at the Project site level. We noted that the Project's procedures include document imaging, quality control measures for document indexing, retention of physical files onsite for two years, and offsite archiving of older documents with no provision for document destruction.

We believe that the DPW Project staff has implemented a Project documentation system that meets or exceeds the requirements of the DPW Project Management Division Procedures Manual and the Code of Federal Regulations. In addition, an upgrade of the existing document control software system completed in February 2003 should further enhance the Project's documentation requirements.

II. Procurement, Use and Safeguarding of Assets

Objectives

Our primary audit objective was to determine whether the DPW Project staff has established appropriate internal controls over the procurement, use and safeguarding of the Project's portable and fixed assets, and that asset purchases are reasonable and purchased within appropriate County procurement policy.

Scope

We reviewed asset purchases and documentation, conducted interviews with various personnel, and reviewed the requirements governing the handling and processing of reimbursable expenditures as stipulated in PMD-2, Consultant Contract Reimbursables. In addition, we also sampled portable and fixed asset purchases to measure compliance with established procedures.

Results

Controls Over the Procurement, Use and Safeguarding of Assets Were Found to be Adequate

All portable and fixed asset purchases have been made through the reimbursable portion of the Construction Management Contract with JFI. These purchases principally consist of site office furniture and fixtures, computer hardware/software, and equipment. These procurements are governed by the review and processing protocols as stipulated in PMD-2, which is the section of the DPW Project Management Division Procedures Manual addressing the handling of consultant contract reimbursables. In particular, PMD-2 requires that all reimbursable purchases over \$100 be approved via a Letter of Authorization.

JFI provided a budget for reimbursable items by category and fiscal year. The reimbursable expense categories utilized by the Project include:

- (a) Hardware cost for PC workstations and portables
- (b) Software and maintenance cost for PC workstations and portables
- (c) Network hardware, software and maintenance
- (d) Shipping and tax (for above)
- (e) Miscellaneous equipment
- (f) Start-up supplies
- (g) Telephone system installation
- (h) On-site office furniture cost
- (i) On-site trailers
- (j) Monthly office supplies
- (k) Office site-work cost

(l) Site office utilities

We noted that all reimbursable expenditures are recorded and classified into the above categories. This categorization allows the Project's managers to monitor expenditures by both category and fiscal year, and provides them with effective management control over the procurement of assets.

We reviewed all individual portable and fixed asset purchases greater than \$1,000 through fiscal year 2002. Our testing found that asset purchases were made in compliance with PMD-2, and proper authorization and approvals were obtained in advance of the purchase.

We verified that all assets are properly tagged and periodic inventories conducted. Furniture and fixtures and computer equipment are assigned by individual and location. Procedures are in place to ensure that the custody of assets is properly accounted for when employees transfer in and/or out of the Project. Lastly, we observed that the office trailer complex has an appropriate security system, which requires the use of keys and a security code for entering and exiting during non-business office hours.

III. Contract Change Controls

Objectives

Our primary audit objective was to determine whether the DPW Project staff has established appropriate internal controls over the contract change control process to ensure that all contract price changes are reasonable and necessary, and that contract changes are properly authorized and approved over the Project.

Scope

We reviewed the FEMA Applications Handbook, County Fiscal Manual, DPW Project Management Division Procedures Manual, State Public Contract Code and the applicable County contracting ordinances. We interviewed Project personnel to discuss the contract change control process, and assessed the implementation of policies and procedures through the review of contract changes for the site preparation contract with Aman Environmental Construction, Inc.

Results

Procedures Governing Contract Changes

Contract change control policies and procedures are outlined in PMD-10. These procedures require reviews to ensure that changes are reasonable and necessary, that adequate budget is available and that prices are fair and reasonable. The procedures also require approval at identified approval levels by DPW and County officials.

Approval levels identified in PMD-10 were consistent with State law and County ordinances except for changes to contracts with values between \$250,000 and \$1,250,000. PMD-10 states that DPW could authorize changes for contracts equal to 10% of the contract's value up to \$75,000, with original values ranging from \$250,000 to \$1,250,000. State law allows DPW to authorize changes with values equal to 10% of the first \$250,000 in original contract value and 5% of the amount over \$250,000 up to a change order value of \$75,000. This inconsistency was discussed with Project Management Division I on November 18, 2002, and a revision to PMD-10 was made on December 3, 2002, to be consistent with State Public Contract Code Section 20145.

Review of Construction Change Orders

We selected a sample of 8 contract changes to the Aman Environmental Construction, Inc., with a total value of \$649,452 to verify the proper implementation of DPW change control procedures. We found all contract changes were reasonable and necessary, the negotiated price was reasonable when compared with the estimate, and total cost was within the budget. We also found that DPW contract change approval level policy was followed in all cases and that the inconsistency noted and discussed above in regard to

PMD-10 did not result in any change order approval in excess of levels authorized by State law.

Contract Change Order Price Reviews

DPW has established procedures to ensure that prices for contract changes are fair and reasonable. Contractors are required to provide itemized breakdowns with their change order proposals that provide for all added and deleted labor, material, and construction equipment. Furthermore, the DPW Project staff establishes pre-negotiated labor and equipment rates for prime contractors and major subcontractors. When contractors submit their proposed rates, the Project staff verifies the proposed labor rates to union agreements, prevailing wages and/or certified payrolls. Certified payrolls that detail actual labor cost by individual and labor category are provided to the Project staff throughout the contract. Project staff also assesses the reasonableness of equipment use rates through a comparison to industry standards. Following this verification and assessment, Project staff negotiates "advanced agreement" labor and equipment rates to be used for future change order negotiations. In addition, Project staff performs these verifications and assessments for other than major subcontractors whenever changes are proposed.

Recognizing the adequacy of the DPW Project staff's contract change order policies and procedures, we believe that the contract change control process could be enhanced by requiring that change order approvals include some form of documentation or assurance that all change order pricing checks have been performed. We further believe that advanced agreement labor rates should be reviewed at least annually to ensure these rates are consistent with the actual labor rates paid as shown in the certified payrolls.

Recommendations

Project Management Division I should ensure DPW Project staff compares certified payrolls of prime and major subcontractors with rates used for negotiating changes on at least an annual basis to ensure that rates negotiated for changes are consistent with actual rates experienced by those contractors. Whenever differences are noted, any pre-established negotiated rate should be revised accordingly.

DPW Project staff should also establish a procedure requiring that change order approvals include a checklist evidencing that procedures for establishing reasonable prices have been followed. This checklist should include, at a minimum, statements that equipment and labor rates proposed for a change order have been compared with advanced agreement rates, and that new advanced agreement rates have been established after assessment of proposed rates for those cases where no advanced agreement rate exist. This checklist should also include a statement that the proposal has been reviewed to ensure that mark-up on labor, material, and equipment has appropriately been included on the deleted work.

IV. Contractor Payments

Objectives

Our primary audit objective was to determine whether the DPW Project staff has established appropriate internal controls to ensure that consultants and contractors are performing in compliance with their contract provisions, pay requests and invoices are reviewed for accuracy before payment is made, and changes made to billing rates, contract amounts, and Project schedule are properly documented by contract amendments.

Scope

We performed detailed testing of contractor invoices covering Project expenditures during FY 2001 and 2002. We selected a sample of 49 invoices submitted by nine separate Project contractors and consultants totaling \$15,749,802, which represents 47.5% of the total dollar volume of payments made during this two-year period.

Invoices sampled were submitted by the following contractors/consultants:

1. Hellmuth, Obata, Kassabaum - Architectural Services
2. Jacobs Facilities Inc. (formerly CRSS) - Construction Management
3. Management Specialty Services - Administrative Support
4. Aman Environmental Construction - Site Preparation
5. Dames & Moore - Geotechnical Services
6. Kleinfelder, Inc. - IOR Inspection Service
7. F.H. Paschen, S.N. Neilsen - Job Order Contractor/Site Preparation
8. MacKone Development - Job Order Contractor/Site Preparation
9. Southwest Industries - Job Order Contractor

The purpose of our testing was to verify that:

- ✓ A properly executed contract, agreement or work order exists to cover the specific scope of services
- ✓ The billing method was in conformance with the contract agreement and complies with DPW Project Management Division Procedures Manual, i.e., PMD-12A or PMD-12B, as may be applicable.
- ✓ The invoice is mathematically correct.
- ✓ All invoice charges are properly categorized and coded as prescribed.
- ✓ Retention amounts have been properly calculated, if applicable.
- ✓ Labor hours and labor rates are billed in compliance with the agreement or contract.
- ✓ Labor charges are supported by properly approved timesheets and/or certified payrolls, as may be applicable.
- ✓ Subcontractor costs are billed in conformance with the agreement or contract, as may be applicable.

- ✓ Reimbursable costs charged are in conformance with the agreement or contract.
- ✓ Optional costs are in accordance with contract provisions, as may be applicable.
- ✓ Non-labor costs charged are properly supported by the appropriate back-up documentation.
- ✓ Proper authorization by a DPW representative was obtained in advance of the purchase of reimbursable Project assets, if applicable.
- ✓ The invoices were subjected to the review and approval process as prescribed by DPW procedures, and approval of the responsible manager was obtained.

Results

Controls Over Contractor Payments

The processing of contractor pay requests and consultant pay requests are governed by the requirements stipulated in PMD-12A and PMD-12B, respectively of the DPW Project Management Division Procedures Manual. Interviews with Project staff indicate they are knowledgeable of the contractor and consultant payment process. Our detailed testing of invoices found that contractor and consultant billings and payments were accurate, properly authorized/approved, supported by adequate back-up documentation, and were being billed in accordance with contract provisions and applicable DPW procedures.

V. Use of Optional and Reimbursable Service Components in Consultant Service Contracts

Objectives

Our primary audit objective was to determine whether the DPW Project staff has established proper policies and procedures for the appropriate levels of approving the use of optional and reimbursable service components of all consultant contracts, and that the use of these services comply with applicable fiscal and Project policies and procedures.

Scope

We conducted interviews with the Project staff and reviewed all current consultant contracts. We also reviewed the applicable policies and procedures governing the process for requesting reimbursable expenditures and approving invoices for reimbursable costs. These included the following:

- 1) DPW Project Management Division Procedures Manual PMD-2, Consultant Contracts' Reimbursables, dated April 9, 1998, and
- 2) DPW Project Management Division Procedures Manual PMD-12B, Consultant Invoice Processing, dated August 31, 2000.

Results

Minimal Use of Optional and Reimbursable Service Components in Consultant Service Contracts

The DPW Project staff appears knowledgeable of the DPW Project Management Division Procedures Manual to approve and control reimbursable expenses. We observed and noted the usage of requisition and review forms developed by staff specifically for the purpose of controlling and approving reimbursable expenses. Staff interviews also confirmed a keen understanding of the compliance requirements to verify and approve cost reimbursable invoices, as stipulated in PMD-12B.

Contract options are defined as unfunded itemized requirements that may be initiated at the discretion of the County. They are not included in the consultant's not-to-exceed fee and require a Supplemental Agreement to initiate. Our review noted that contract options exist only in the Construction Management Contract with Jacobs Facilities, Inc. (JFI). These options are limited to Post Occupancy Planning and an Owner Controlled Insurance Program. Since the use of options was found to be minimal, there appears to be no discernable risk exposure to the County at this time.

Reimbursable service components were found to exist in two of the thirteen consultant service contracts. Funds totaling \$3.6 million were budgeted for reimbursable expenses

in the Construction Management Contract, amounting to only 7.5% of the total construction management budget. Funds totaling \$451,000 was budgeted for reimbursable expenses in the A/E Design Contract, amounting to only 1.0% of the total A/E design contract budget. Initiation and use of the reimbursable provisions under these two contracts was found to be in compliance with the DPW Project Management Division Procedures Manual.